Towards an Adaptive Economic Model for Microstates - The Importance of Company Law Reform in International Regulatory Competition

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Abstract and Introduction

In the international arena of regulatory competition for global incorporations, microstates such as the Channel Islands are fierce competitors with international onshore and offshore jurisdictions, offering tax advantages, specialist incorporation regimes and innovative financial services. On the one hand, policy-makers outside of these microstate jurisdictions may criticise them as 'tax havens'. On the other hand, these jurisdictions have largely grown their economic models in an effort to engage in global competition for internationally mobile economic entities and capital, while at the same time meeting domestic economic needs. International regulatory competition is entering into a game-changing phase as a number of developed countries have taken steps to put increased pressure on what they perceive as 'unfair tax competition'. The OECD is also developing multilateral initiatives with such impact. Microstates such as the Channel Island of Alderney take the view that they remain important and engaged in the international arena of regulatory competition as they provide a stable and competitive incorporation jurisdiction for globally mobile entities and capital. Based on a consultancy project that the authors undertook for the States of Alderney (part of the Bailiwick of Guernsey in the Channel Islands), the authors have engaged with the early steps of potential company law reform in Alderney in order to bring about a modern and attractive incorporation destination in the microstate.

Part A of the article will discuss the common features of microstates' economic models in international regulatory competition and highlight changes afoot in the international crack-down in unfair tax competition. Part B discusses Alderney's context and their role in international regulatory competition for incorporations. Part C, the longest Part of this article, provides the key highlights of company law reform that are important to Alderney in this new era of international regulatory competition. Part D concludes.

We appreciate that in the absence of empirical research that shows how each company law aspect is relevant to the attractiveness of a jurisdiction as an incorporation jurisdiction, the company law aspects that we highlight do not provide correlative or causal evidential value. However, each incorporation jurisdiction has characteristics that are unique for its appeal to niche regimes, and so an abstract comparative and empirical exercise may not capture those fully. Further, this study is valuable as it is based on Alderney's desire to introduce certain attributes of 'onshore' jurisdictions such as the UK in order to enhance its appeal as an incorporation jurisdiction - illustrating the point that international regulatory competition is a dynamic involving differentiation as well as convergence, and not simply a race to the top or bottom. The highlighted areas of reform show areas of convergence that we suggest are valuable to Alderney in its role in international regulatory competition, which we will argue, is moving away from simple competition in terms of cost of business, which underlies international tax competition.

A. Common Features of the Economic Model of Microstates

In the modern landscape of providing services to international business, microstates are a key supplier of incorporation jurisdictions for corporate and financial vehicles under the umbrella of international corporate groups. Attracting incorporations of corporate subsidiaries or investment fund vehicles generates inflows of capital to such microstates, creating revenue and jobs. Such regulatory competition is supported for its importance in fostering regulatory innovations,[1] achieving optimal and efficient rules[2] and preventing monopolistic domination over rule-making by inefficient constituents.[3]

However, many microstates participate in international regulatory competition by providing incentives such as low or no taxes. The low tax economy of microstates encourages the migration of legal structures (whether or not associated with real productive activity) and financial flows in order to benefit from the low tax domicile of the tax havens. [4] The OECD[5] defines a tax haven as a jurisdiction where:

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* to ****affiliations to be inserted.

[1] Roberta Romano, 'The States as a Laboratory: Legal Innovation and State Competition for Corporate Charters' (2006) 23 Yale Journal on Regulation 209; *The Genius of American Corporate Law* (AEI Press 1993).

[2] Romano (2005), (2006), above, but for doubts see Henri Tijong, 'Breaking the Spell of Regulatory Competition: Reframing the Problem of Regulatory Exit' (2002) 66 The Rabel Journal of Comparative and International Private Law 66; Frank Gervurtz, 'The Globalization of Corporate Law: The End of History or a Never-Ending Story?' (2011) 86 Washington Law Review 475; Marcel Kahan and Ehud Kamar, 'The Myth of State Competition in Corporate Law' (2002) 55 Stanford Law Review 679.

[3] William J Carney, 'The Political Economy of Competition for Corporate Charters' (1997) 26 Journal of Legal Studies 303.

[4]Offshore financial centres can be classified into three groups: functional, compound, and notional. A functional OFC can be defined as being where financial activities actually take place, where full branches of banks, plus other financial services such as fund management, trust companies etc. are sited. Functional OFCs employ a significant proportion of local labour. Compound OFCs host a mixture of functional and notional activities. This category includes centres (eg. The Bahamas) that have an increasing number of shell offices that eventually become fully operational branches. Such OFCs employ a smaller proportion of the local labour force than functional OFCs (3-10 %) and contribute an estimated 10-24 % of GDP. Notional OFC are where 'shell' or brass plate offices of banks make book entries of financial transactions. However, their employment and GDP data is fragmented and incomplete. See Mark P Hampton, 'Creating Spaces. The Political Economy of Island Offshore Finance Centres: The Case of Jersey' (1996) 84 Geographische Zeitschrift 103; G Baldacchino, 'Bursting the Bubble: the Pseudo-Development Strategies of Microstates' (1993) 24 Development and Change 29-51.

[5] *Harmful Tax Competition* (1998) at http://www.oecd.org/tax/transparency/44430243.pdf.

(a) there are no or only nominal taxes (and offering, or being perceived as offering, a place for non-residents to escape tax in their country of residence);

(b) there is a lack of transparency (such as the absence of beneficial ownership information and bank secrecy);

(c) there is unwillingness to exchange information with the tax administrations of OECD member countries;[6] and

(d) there is absence of a requirement that activity be substantial (transactions may be "booked" in the country with little or no real economic activity).

Microstates may find it attractive to run a tax haven economic model as many of them are resource-scarce and would not be competitive in global international trade.[7] Further, many of them were part of old colonial empires, such as the British Virgin Islands, and already benefit from institutional and legal infrastructure inherited from the former motherland that could be used to serve the needs of multinational corporations and internationally mobile capital.[8] The former British dependencies and territories have inherited a common law system that is friendly to the creation of beneficial ownership structures to protect money and assets.[9] Further, the relatively small populations of microstates place less public spending demands on governments. Therefore, the relatively light fiscal burdens in these microstates allows such governments to put in place low-tax fiscal policies that are outwardly attractive to foreign incorporations and fund flows, and yet do not compromise

[6] International reforms since the 1998 OECD report have changed the phenomenon in (c) somewhat as the OECD's blacklist of uncooperative tax havens has forced a number of jurisdictions to sign a sufficient number of bilateral information exchange treaties with other non-haven countries in order to be elevated from the blacklist to the grey or white lists.

[7] Mark P Hampton and John Christensen, 'Offshore Pariahs? Small Island Economies, Tax Havens, and the Re-configuration of Global Finance' (2002) 30 World Development 1657; George A Cavalier, 'Redesigning Heaven: Tax Haven Reform in the Netherlands Antilles' (2009) 13 Tax Notes International 1009; Dhammika Dharmapala and James R. Hines Jr, 'Which Countries Become Tax Havens?' (2009) 93 Journal of Public Economics 1058.

[8] Mihir A. Desai, C. Fritz Foley, James R. Hines Jr, 'The Demand for Tax Haven Operations' (2006) 90 Journal of Public Economics 513.

[9] Mark P Hampton and Michael Levi, 'Fast Spinning into Oblivion? Recent Developments in Money-Laundering Policies and Offshore Finance Centres' (1999) 20 Third World Quarterly 645 discuss how former colonial status has helped former British territories- the ties with the previous motherland and inheritance of a commercially friendly common law system. However, note Shaxson's damaging journalistic account of how previous colonial powers continue to use their former territories in shady financial dealings, in order for onshore institutions to appear disengaged. Nicholas Shaxson, *Treasure Islands: Tax Havens and the Men who Stole the World* (London Vintage 2012).

domestic economic needs.[10] Further, many microstates see themselves as offering 'safe havens' for international capital, being subject to low and stable tax and regulatory environments, as well as flexible incorporation options for a variety of forms of corporate structuring which serve strategic purposes in investment, asset partitioning and so on.

The economic model of the tax haven has attracted international criticism as well as support in equal fervour. Critics regard the tax haven economic model as providing harmful tax arbitrage and competition.[11] However such behaviour is usually structured in a way that is nevertheless legal, and Sharman is of the view that microstates therefore offer a form of 'calculated ambiguity'[12] to further arbitrage behaviour by multinational corporations. Such calculated ambiguity is made possible as it is backed by the microstate sovereignty and legal independence. Critics of the tax haven economic model are of the view that tax competition is unfair and a form of competition in laxity.[13]

Further, bank secrecy laws that complement the tax haven/offshore financial centre economic models are viewed negatively by critics as they hamper the enforcement efforts of onshore jurisdictions for tax evasion. [14] Secrecy also assists in more nefarious behaviour

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[10] Dhammika Dharmapala and James R. Hines Jr, 'Which Countries Become Tax Havens?' (2009) 93 Journal of Public Economics 1058. Ronen Palan, 'Tax Havens and the Commercialization of State Sovereignty' (2002) 56 International Organisation 151.

[11] OECD, *Harmful Tax Competition,* above. David W. Conklin and Darroch (Rick) A. Robertson, 'Tax Havens: Investment Distortions and Policy Options' (1999) 25 Canadian Public Policy 333. Joel Slemrod and John D Wilson, 'Tax Competition with Parasitic Tax Havens' (2009) 93 Journal of Public Economics 1261. A catalogue of behaviour by multinational corporations that use tax havens could adversely affect the level of tax revenues that home countries of such corporations can collect. For example, multinational corporations use tax havens to keep foreign income so that tax paid to the home country will be minimised. Governments of mobile multinational corporations are forced to keep taxes sub-optimally low so that the wholesale migration of such corporations would be prevented. In either case, the home country suffers a reduction in tax revenues and hence is able to spend less on public welfare, decreasing welfare levels overall in the home country. This view would place tax haven jurisdictions in the negative light of being parasitic economies and 'stealing' from non-haven jurisdictions.

[12] Jason Sharman, 'Offshore and the New International Political Economy' (2010) 17 Review of International Political Economy 1.

[13] Dale Murphy, *The Structure of Regulatory Competition* (Oxford: Oxford University Press 2004) opining that indeed in some areas, offshore regulatory competition has resulted in a race to the bottom, such as in offshore finance. However some would disagree, for example see Rose-Marie Belle Antione, 'The Legitimacy of the Offshore Financial Center: A Legal Perspective' in Andrew P Morriss (ed), *Offshore Financial Centers and Regulatory Competition* (AEI Press 2010) at 30.

[14] Clemens Fuest, 'Tax Havens: Shady Deals' (2011) 67 The World Today 16; Timothy V Addison, 'Shooting Blanks: The War on Tax Havens' (2008) 16 Indiana Journal of Global Legal Studies 703; Guttorm Schjelderup, 'Secrecy Jurisdictions' (2015) International Tax Public Finance CHK. S Corkill Cobb, 'Global Finance and the Growth of Offshore Fi.nancial Centers: The Manx Experience' (1998) 29 Geoforum 7.

that may involve illegality on the part of corporations and individuals, corruption involving politicians (especially of emerging economies), and increasingly terrorist financing for rogue organisations. Further, commentators have pointed out the complementarities of secrecy regimes[15] for money-laundering activities, for the sheltering of ill-gotten gains such as bribes accumulated by corrupt politicians and government officials in emerging economies. However, commentators in defence of offshore tax and financial centres find that tax havens that have a reputation to defend have generally established high standards of regulation and good political and administrative governance, and so are not welcoming to money-laundering activities.[16]

Moreover Blum *et al*[17] point out that money laundering is a systemic underground operation that spans the globe, and both onshore and offshore jurisdictions are used by determined launderers. Tax havens thus are not of primary importance in sustaining such operations. Further, secrecy regimes should not be condemned as such as they can be used for good – to protect the assets of entrepreneurs of oppressive regimes whose assets may otherwise be expropriated by corrupt and powerful politicians and bureaucrats.[18]

Although one could take a balanced approach, appreciating the limited choices of microstate economic modelling while being aware of the part they play in welfare-decreasing consequences for affected onshore states, international policy pressure has always been critical of tax havens.

Sharman[19] discusses how, in the 1990s, leading large non-haven jurisdictions, under the auspices of the OECD, have attempted to exert pressure on tax havens. However, these moves have become largely rhetorical and restrained as there is a dimension of unfairness in persecuting or bullying essentially defenceless tax haven microstates. A compromise has

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[15] Jack A. Blum, Michael Levi, R. Thomas Nayior and Phil Williams, ‘"Financial Havens, Banking Secrecy and Money Laundering," Double Issue 34 and 35 of the Crime Prevention and Criminal Justice Newsletter, Issue 8 of the UNDCP Technical Series, May 1998’, extracted in Trends in Organised Crime 1999 at 68; Peter Schwarz, ‘Money Launderers and Tax Havens: Two Sides of the Same Coin?’ (2011) 31 International Review of Law and Economics 37.

[16] Dhammika Dharmapala and James R. Hines Jr, ‘Which Countries Become Tax Havens?’ (2009) 93 Journal of Public Economics 1058; Andrew P Moriss and Clifford C Henson, ‘Regulatory Effectiveness & Offshore Financial Centers’ (2012) at http://ssrn.com/abstract=2016310.

[17] Jack A Blum et al., ‘Preliminary Report, "Financial Havens, Banking Secrecy, and Money Laundering." United Nations Office for Drug Control and Crime Prevention, Global Programme Against Money Laundering, May 199’ extracted in *Trends in the Global Drug Trade* at 121

[18] Andrew Morriss, ‘The Role of Offshore Financial Centers in Regulatory Competition’ (2008) at http://papers.ssrn.com/pape.tar?abstract_id=1275390.

[19] J.C. Sharman, *Havens in a Storm: The Struggle for Global Tax Regulation* (Ithaca NY: Cornell University Press 2006) especially chapters 2 and 3.

been reached to secure more cooperation from tax havens without severe damage to their economic model. Since the global financial crisis of 2008-9 however, there has been a marked change in the tenor of international policy pressure. In particular, leading onshore jurisdictions such as the US and UK have taken determined steps to enact extra-territorial legislation to severely undermine the tax advantages and secrecy regimes that many microstates use to support their positions in international regulatory competition.

The Rise of Automatic Information Reporting Regimes

In 2011, the US passed the Hiring Incentives to Restore Employment Act in which the Foreign Account Tax Compliance Act ('FATCA') was introduced to come into force in 2014. FATCA achieves an astonishing level of extra-territoriality. It requires all United States citizens, including individuals who live outside the United States, to report their financial accounts held outside of the United States. It also requires all global non-US financial institutions to search their records for accounts associated with suspected US citizens, in order to report their assets and identities to the US Treasury. FATCA introduces comprehensive and costly compliance for foreign financial institutions in order to make reports to the US Treasury, along with a punishment of a 30% withholding tax on all US-sourced income if the foreign financial institution fails to comply.[20] This has given rise to an 'automatic information reporting' regime whereby the onus is reversed onto financial institutions to supply tax intelligence to national authorities. National authorities need not go through the inconvenient processes of trying to uncover opaque tax information in order to initiate exchange of information with tax haven jurisdictions.

By requiring global financial institutions to report on US citizens' accounts and assets abroad, FATCA effectively rides roughshod over tax havens' secrecy regimes and renders the opacity services provided by tax havens and offshore financial centres redundant for US citizens.[21] Further, FATCA has inspired international convergence towards an automatic information reporting system. The EU and UK have embarked on similar measures and an international template is being developed under the auspices of the OECD.[22]

[20] See Mark R van Heukelom, 'The Foreign Account Tax Compliance Act and Foreign Insurance Companies: Better To Comply than To Opt Out' (2013) 39 Journal of Corporation Law 102 for a discussion of the FATCA provisions.

[21] Itai Grinberg, 'Beyond FATCA: An Evolutionary Moment for the International Tax System' (2012) at http://ssrn.com/abstract=1996752 (2012) 60 UCLA Law Rev 304. Susan Morse, 'Tax Compliance and Norm Formation Under High-Penalty Regimes' (2012) 44 Connecticut Law Review 375; Joshua D. Blank and Ruth Mason, 'Exporting FATCA' (2014) Tax Analysis 1245.

[22] https://www.oecd.org/tax/automatic-exchange/.

In the EU, the Administration Cooperation Directive[23] imposes mandatory automatic information reporting on income from employment, life insurance products, pensions as well as ownership of, and income from, real property. The EU Savings Directive of 2014[24] now provides that payments of interest income, whether directly or indirectly derived, that are made by paying agents in the EU to entities (whether onshore or offshore) with a beneficial owner resident in the EU must be reported to relevant national authorities in order to ascertain the identities of beneficial recipients. Automatic information reporting is the key mechanism used in the Directives as well, but with a more limited scope, as only paying agents in the EU are affected, in relation to entities associated with an EU beneficial owner. During the transitional period of the Directive, a number of European member states such as Austria, Luxembourg and microstates such as Monaco and Liechtenstein, as well as UK Crown dependencies, have all opted to apply a withholding tax of 35% rather than subvert their bank secrecy regimes.[25] EU residents are, however, not absolved from their own reporting obligations.[26]

On these points, the EU regime is arguably not as extensive and draconian as FATCA, as FATCA makes major inroads into banking secrecy in addition to achieving tax revenue collection. However, we are of the view that the international crack-down on tax competition is only gathering pace, as the EU embarks on disincentivising corporates from aggressive tax planning through obligations in corporate disclosure that produce a name-and-shame effect;[27] and the UK embarks on extensive reforms in criminal and administrative sanctions against tax evasion and aggressive tax planning. Although developed jurisdictions assert that such tax competition is 'unfair', our account above has attempted to show that this remains a debate, and one could take a balanced account of internationally unequal tax regimes.

First, the UK has in late 2013 concluded agreements with all of its Crown dependencies to require automatic information reporting of UK residents' income and funds held in such

[23] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC.

[24] Above.

[25] Lukas Hakelberg, 'The Power Politics of International Tax Co-Operation: Luxembourg, Austria and the Automatic Exchange of Information' (2015) 22 Journal of European Public Policy 409.

[26] Luis V Cavelti, 'Automatic Information Exchange versus the Withholding Tax Regime Globalization and Increasing Sovereignty Conflicts in International Taxation' (2013) World Tax Journal 172; Melissa A Dizdarevic, 'The FATCA Provisions of the Hire Act: Boldly Going Where No Withholding Has Gone Before' (2011) 79 Fordham Law Review 2967.

[27] See 'European Commission proposes public tax transparency rules for multinationals' (12 April 2016) at http://europa.eu/rapid/press-release_IP-16-1349_en.htm.

offshore entities regardless of where the funds are incorporated and managed or where income is generated and received.[28]

Next, the UK Treasury published a number of consultation papers in the summer of 2015 to introduce new criminal sanctions for tax evaders[29] and severe civil penalties for them.[30] There are already in place financial penalties for tax evaders, but the new sanctions would raise the penalties to match the values of assets hidden from tax authorities so as to destroy the incentives for tax avoidance. Further, where large businesses engage in tax planning and not necessarily evasion, they are required to publish their tax strategies and policies, make adequate disclosure to the UK tax authorities and comply with a voluntary Code of best practices. Failure to achieve those standards may result in these businesses entering into a 'special measures' regime with the tax authorities that would entail increased scrutiny, possible withdrawal of privileges such as the ability to tender for government procurement and public naming and shaming.[31]

Finally, the HM Treasury has proposed that enablers or assisters of tax evasion should be subject to criminal liability[32] and severe civil penalties too.[33] The scope of enablers and assisters is rather wide, and the consultation paper provides examples of who may fall within its scope. A noted example of interest in microstate tax havens is that microstate corporate services and financial institutions that provide services to facilitate successful tax avoidance would be regarded as an enabler or assister within the scope of the proposed legislation. They can therefore be pursued by the UK authorities on an extra-territorial basis.

The UK's extra-territorial enforcement against individuals in the corporate and financial services sector who undertake tax and financial planning could be a fearsome disincentive for such individuals. These measures, if robustly enforced, could be the first steps towards dismantling the tax haven economic model.

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[28] Bruce W Bean and Abbey L Wright, 'The U.S. Foreign Account Tax Compliance Act: American Legal Imperialism?' (2015) 21 ILSA Journal of International and Comparative Law 1.

[29] HM Treasury, *Tackling Offshore Tax Evasion: A New Criminal Offence for Offshore Evaders* (16 July 2015).

[30] HM Treasury, *Tackling Offshore Tax Evasion: Strengthening Civil Deterrents for Offshore Evaders* (16 July 2015).

[31] HM Treasury, *Improving Large Business Tax Compliance- A Consultation* (24 July 2015).

[32] HM Treasury, *Tackling Offshore Tax Evasion: A New Corporate Criminal Offence of Failure to Prevent the Facilitation of Evasion* (16 July 2015), second consultation in April 2016, see https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/517020/Tackling_tax_evasion-legislation_guidance_corporate_offence_of_failure_to_prevent_criminal_facilitation_tax_evasion.pdf.

[33] HM Treasury, *Tackling Offshore Tax Evasion: Civil Sanctions for Enablers of Offshore Evasion* (16 July 2015).

The rise of extra-territorial measures such as automatic information reporting and extra-territorial enforcement for aggressive tax behaviour is changing the landscape for international regulatory competition. Further, negative opinion championed by the US, UK and EU against aggressive tax behaviour has increasingly cast such behaviour as a form of reputational risk for corporate investors.[34] Hence, microstates need to rethink how far tax competition can further their comparative advantage in international regulatory competition for global incorporations. We are of the view that international regulatory competition cannot itself be weeded out and, moreover, that it should not be weeded out due to the advantages that such competition can bring, such as in efficiency and beneficial innovation. However, what is certain is that the terms of competition are changing, and are tending towards substantive aspects that balance the cost-efficiency needs of corporates with their reputational needs in being well-governed and having a positive profile as a global social citizen. As incorporation jurisdictions embark on redefining their global appeal and the terms of international regulatory competition, the authors were commissioned by the States of Alderney, a Channel Island jurisdiction, to study the prospects for company law reform (excluding tax law), in particular in comparison with the UK, to develop an attractive framework for global incorporations.

B. Alderney's Adaptive Choice

Commentators have wondered aloud whether new challenges such as those discussed above may endanger the microstates' sovereignty as well as economic survival.[35] For example, the Netherlands Antilles has marginalised its tax haven economic model to become more internationally convergent and has therefore reduced the scope of its role in tax competition.[36] Moreover, many microstates have also adapted to international challenges by reforming their economic models to engage in more acceptable forms of international regulatory competition, primarily for incorporations and modern financial services.[37] As early as post 2001, the Isle of Man has been trying to develop investment fund structures for the film industry and private space travel companies,[38] thereby adding to efforts to shake off any reputational association with illegal transactions such as money laundering.

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[34] Eg see UNPRI, *Engagement Guidance on Corporate Tax Responsibility* (2014) at https://www.unpri.org/download_report/8531.

[35] George A Cavalier, 'Redesigning Heaven: Tax Haven Reform in the Netherlands Antilles' (2009) 13 Tax Notes International 1009.

[36] above.

[37] See positive assessments in Andrew Morriss (ed), *Offshore Financial Centers and Regulatory Competition* (AEI Press 2010) generally.

[38] Sharon C Cobb, 'Globalization in a Small Island Context: Creating and Marketing Competitive Advantage for Offshore Financial Services' (2001) 83 Geografiska Annaler 161.

Alderney, which provides the case study in this article, is a tiny island in the English Channel of about 3 square miles. It was annexed by the Duchy of Normandy in the 11th century and continued under British rule until 1948 when the island broke away from British fiscal rule and became part of the Bailiwick of Guernsey. It was too small and lacked self-sufficiency to be independent, but it retained its own administration known as the States of Alderney. The States has pursued a low-tax fiscal policy as Alderney's chief economic model, and provides offshore financial services, consistent with the economic model of Guernsey.

Even if Alderney continues to provide a low tax environment (which would be possible given that it has little need for extensive fiscal policies and public services), Alderney is developing a comparative advantage that goes beyond tax-efficiency alone. In exploring the aspects of its regulatory sovereignty that can be shaped to provide services for global business, [39] Alderney is increasingly attracting globally mobile businesses that are private and small but have an international presence, such as online enterprises. This is a market that has developed ferociously since the coming of the Internet age. However, these organisations, particularly in light of the international tax crack-down on internet giants such as Amazon and Google, benefit from incorporation regimes that are able to provide a balance of stable cost-efficient structures with standards of good governance and responsibility that have international appeal. To this end, Alderney is looking to reform its company law framework to incorporate aspects of high governance and responsibility standards that are convergent with onshore jurisdictions like the UK, while providing an efficient and cost-effective incorporation regime.

Modern Regulatory Competition for Incorporations

The reform of company law pertains to the branding and framing of a legal infrastructure for incorporations and possibly, reincorporations. In our consultancy engagement, we were not tasked with relating company law reform to any specific sectors, but we suggest that incorporations and reincorporations in relation to different sectors will likely entail different needs. Rather, we took a broad level perspective in exploring what company law reform may offer. Although revenue directly obtained from incorporations may be limited,[40] incorporations foster growth in ancillary corporate and financial services and can be a large source of local income.[41] Further, incorporation jurisdictions can create positive network effects for companies in the same sector and build up a jurisdiction's reputational capital over the long-term.

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[39] Andrew Morriss, 'The Role of Offshore Financial Centers in Regulatory Competition' (2008) at http://papers.ssrn.com/pape.tar?abstract_id=1275390.

[40] Eva Maria Kieninger, 'The Legal Framework of Regulatory Competition Based on Company Mobility: EU and US Compared' (2005) 6 German Law Journal 741.

[41] Roberta Romano, 'Is Regulatory Competition a Problem or Irrelevant for Corporate Governance?' (2005) 21 Oxford Review of Economic Policy 212.

International trends indicate that many onshore and offshore jurisdictions are increasingly concerned about high standards in corporate law, especially in relation to corporate governance. This is in large part due to the rise of global collective investment management, which includes institutions[42] and alternative investments such as hedge and private equity funds. [43] The growth of global collective investment management may be characterised as a form of 'financialisation' of household and corporate finance, bringing the centricity of shareholder value as a corporate objective to the fore.[44] The absorption of the shareholder-centric model into global corporate governance has been gradual but marked.[45] As international investment capital is highly mobile,[46] globally competitive stock exchanges and securities regulators have in response adopted Anglo-American corporate governance

[42] The OECD reports that growth in collective investment management has been remarkable since the early 1990s, see John K Thompson and Sang-Mok Choi, 'Governance Systems for Collective Investment Schemes in OECD Countries' OECD Occasional Paper (April 2001). The Price Waterhouse Coopers survey of Asset Management reports that global assets under management stand at about USD$64 trillion at end of 2013, see PwC, *Asset Management 2020: A Brave New World* (2013) at http://www.pwc.com/gx/en/asset-management/publications/asset-management-2020-a-brave-new-world.jhtml. That relates to assets managed by professional asset managers and does not include those managed in-house. In terms of pensions, as of 2012, total assets under collective management in global pensions (where data has been available) stand at approximately USD$30 trillion, total assets managed by insurance companies at approximately USD$24 trillion and total assets managed by other investment funds at approximately USD$22 trillion, http://www.oecd.org/finance/private-pensions/globalpensionstatistics.htm. In Europe, assets under management, including pensions, stand at 13.8 trillion euros at the end of 2011, see EFAMA, *Asset Management in Europe: 6th Annual Review* (2013) at http://www.efama.org/Publications/Statistics/Asset%20Management%20Report/Asset_Management_Report_2013.pdf. Haldane estimates in 2014 a figure of total global assets managed by insurance companies, pension funds, mutual funds and others as representing about twice the size of global gross domestic product, see Andy Haldane's speech estimating global assets managed by institutions to be at USD$87 trillion, at http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech723.pdf.

[43] Alternative investment fund assets are estimated to stand at more than USD$2 trillion, based on Deutsche Bank's *2014 Alternative Investment Survey* at https://www.db.com/medien/en/content/4666_4819.htm. See Gordon L Clark and Darius Wójcik, *The Geography of Finance* (Oxford: OUP, 2007) at chapters 2, 6 and 7.

[44] Paddy Ireland, 'The Financialization of Corporate Governance' (2009) 60 Northern Ireland Legal Quarterly 1; Engelbert Stockhammer, 'Financialization and the Slowdown of Accumulation' in Ismail Erturk, Julie Froud, Sukhdev Johal, Adam Leaver and Karel Williams (eds), *Financialization At Work: Key Tests and Commentary* (Oxford: Routledge, 2008).

[45] Roger M. Barker, *Corporate Governance, Competition, and Political Parties: Explaining Corporate Governance Change in Europe* (Oxford: OUP 2010); Laura Horn, 'Corporate Governance in Crisis? The Politics of EU Corporate Governance Regulation' (2012) 18 European Law Journal 83.

[46] see William W Bratton and Joseph A McCahery, 'The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World' (1997) 86 Georgetown Law Journal 201; Ehud Kamar, 'Beyond Competition for Incorporations' (2006) 94 Georgetown Law Journal 1725; Chris Brummer, 'Corporate Law Preemption in an Age of Global Capital Markets' (2008) 81 S California Law Review 1067.

standards as part of securities regulation in the regulatory competition for listings and institutional investment.[47]

Anglo-American standards of corporate governance are generally regarded as standards of high quality in relation to the key issue of minority shareholder needs, rights and protection. Although much more relevant to jurisdictions with traded and listed corporate sectors, the global impact of the rise of such standards cannot be ignored. Global business is increasingly keen to ensure that they remain attractive to institutional investment capital and therefore seek the branding of good incorporation and listing jurisdictions.[48] Not only are developed onshore jurisdictions fashioning their corporate governance, transparency and capital standards to cater for investor protection and to a certain extent shareholder primacy,[49] offshore jurisdictions that have traditionally relied on their comparative advantage in tax regimes are also reinventing themselves beyond international tax competition.[50] For example, a number of offshore jurisdictions are becoming much more attentive to minority shareholder issues as a key tenet in high standards of corporate governance. The Guernsey Financial Services Commission has adopted a Corporate Governance Code for its key sector, financial services companies, even though most of the sector is structured as private companies. Many such companies are investment fund vehicles and high standards of corporate governance applicable to such companies would directly benefit global investors

[47] Mathias Siems, 'Convergence in Corporate Governance: A Leximetric Approach' (2010) 35 Journal of Corporation Law 729; Carsten Gerner-Beuerle, 'Determinants of Corporate Governance Codes' (2014) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2346673.

[48] For example the bonding thesis in relation to why issuers cross-list in the US, see John C Coffee, Jnr, 'The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications' (1999) 93 Northwestern University Law Review 641; Edward Rock, 'Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure' (2002) 23 Cardozo Law Review 675. Further, although criticised, the 'law matters' thesis championed by La Porta el al who argue that minority shareholder protection rights are crucial to the development of securities markets, play an important part in wedding the standards of minority shareholder protection to good corporate governance and securities regulation. See R La Porta, F Lopez-de-Silanes, A Shleifer and R Vishny, 'Law and Finance' (1998) 106 Journal of Political Economy 1113; R La Porta, F Lopez-de-Silanes and A Shleifer, 'What Works in Securities Laws' (2006) 71 Journal of Finance 1.

[49] The EU for example has raised its game in shareholder rights and protection, see EU Shareholder Rights Directive 2007, Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies and European Commission, Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement (April 2014).

[50] For example, the Swiss Institutional Investor Association has adopted a Stewardship Code that regulates engagement conduct between institutional investors and their investee companies, raising the profile of shareholder primacy. Guernsey has also put in place an official Corporate Governance Code from 2011.

in these funds. Further, case law jurisprudence in the Cayman Islands has also responded to minority shareholder needs by interpreting the standard of directors' legal duties robustly.[51]

The need for global business to respond to the international investment community is a growing one, as for example, global business is increasingly having to contend with shareholder activism.[52] We perceive a spillover effect in terms of the standards of corporate governance demanded of the global equity sector. The key tenet of robust minority shareholder protection has become a more widely-accepted benchmark in normative terms.[53] Even if Alderney wishes to continue to cater for the small private company sector, the sector may be affected by the needs and demands of the global collective investment management sector. Further, professional asset managers would continue to support the institution of standards of corporate governance that conform to their shareholder-centric expectations. We predict that firms may not take narrow minded cost-based approaches in seeking suitable incorporation jurisdictions. The market for incorporations is unlikely to revolve around individual issues such as cost, tax or low regulatory supervision, but a collection of factors offered by different jurisdictions, considered from the point of investment appeal. These will increasingly become important to firms.[54]

In this light, we are of the view that if Alderney wishes to engage in the arena of international regulatory competition for global incorporations, a balanced approach must be taken to meet both the needs of business and the demands of the global collective investment management sector. As mentioned earlier, this article is not based on empirical research on the exact substantive aspects of company law that have incorporation appeal to the corporate and investment sectors. Rather, we have drawn from comparative law, recommending the importation of some of those aspects of UK company law that have been well-regarded. Such convergence serves as a shorthand for identifying salient aspects of company law for international regulatory competition, a point we acknowledge requires testing, but also serves as a gesture of goodwill in Alderney's relations with onshore

[51] *Re the Liquidation of Weavering Capital,* Judgments as of 2011 (High Court) and 2015(Court of Appeal). Directors of a fund company that neglected their duties were first held in the High Court to have wilfully breached their directors' duties. The Court of Appeal considered the lack of diligence and care to have been established although not deliberate or wilful. The case provided clarification on the extent of directors' duties and is now triggering consultation and new practice guidance on how directors in fund companies should conduct themselves.

[52] Dionysia Katelouzou, 'Worldwide Hedge Fund Activism' Dimensions and Legal Determinants' (2015) 17 University of Pennsylvania Law Review 789; Brian R Cheffins and John Armour, 'The Past, Present and Future of Shareholder Activism by Hedge Funds' (2012) 37 Journal of Corporation Law 51.

[53] Although some doubts about the potency of shareholder primacy may be cast in light of the global financial crisis, an episode which has cast shareholders in poor light.

[54] Horst Eidenmüller, 'The Transnational Law Market, Regulatory Competition, and Transnational Corporations' (2011) 18 Indiana Journal of Global Legal Studies 707.

jurisdictions in this rather challenging time of major changes to the terms of international regulatory competition.

We suggest, in thinking anew about the terms of regulatory competition for incorporations, Alderney may wish to provide a framework that caters to both the interests of firms and the international investment community. A framework for incorporations should no longer cater mainly for the needs of international business as the main demand side constituent, but should also cater for the needs voiced by the international investment community, achieving a balance of standards that meet the needs of a wider international stakeholder base.

C. Proposed Aspects of Company Law Reforms

In this Part, we draw from the Gap Analysis of UK and Alderney Company Law that we prepared for the States of Alderney.[55] In line with the requirements of our engagement, the Gap Analysis takes the UK Companies Act 2006 (and amendments thereto) ('UK Act') as a piece of benchmark legislation for comparing the Alderney Companies Act 1994 (and amendments thereto) ('Alderney Act'). It may be argued that the UK regime is not necessarily the most optimal benchmark for Alderney. The UK Act is very much based on the needs of the public and/or traded company with dispersed shareholding, and the same assumption cannot be made of Alderney's corporate sector. However, this 'imbalance' in the UK Act was acknowledged and expressly dealt with in the 2006 reforms to the UK Companies Act,[56] and a 'think small first' approach was deliberately adopted to ensure that company law provisions apply proportionately to small private companies. Thus, while the tenor of the UK Act remains very much catered for the public and/or traded company, given its flexibility and provisions for companies of all sizes it nevertheless offered an appropriate point of comparison for our study.

Alderney's corporate economy is different from the UK, comprising largely of small private businesses, many of them online businesses, and private companies that are part of larger corporate structures or investment fund vehicles.[57] It could be intuited that as such, the needs of Alderney company law should cater mainly for the small private company. However, there are hazards in merely responding to small private companies' needs. These needs are likely to revolve around low cost and low regulatory burdens, and could very

[55] see 'Alderney to Embark on Company Law Reform: Public Consultation Draws on UCL Legal Analysis' (25 Jan 2016) at http://www.alderney.gov.gg/article/151296/Press-Release---Company-Law-Review.

[56] The policy of 'think small first' was introduced in the Company Law Reform white paper and was one of the guiding principles of the UK Act's reform. See: Department of Trade and Industry, Company Law Reform (White Paper, Cm 6456, 2005) (Cm 6456), chapter 4.

[57] Information obtained from the Greffier of Alderney, also the registrar of companies.

easily draw policy-makers responding to such needs in regulatory competition into a 'competition in laxity'.[58]

Finally, as discussed above, the UK's legal framework represents a responsive and high quality set of standards in line with the demands of global investment capital.[59] Alderney's colonial heritage and the international regard for the UK's corporate governance and shareholder protection standards are good starting points to justify the UK as a good comparative subject.

In the following sections, we highlight the aspects of company law that 'brand' the UK as a jurisdiction of high standards and that would be of interest to Alderney given its objectives outlined above. We consider, in particular, four sets of company law standards that will position Alderney to meet the new needs of international business and investment in 'international regulatory competition'. These are the legal frameworks for: easy access to incorporation; corporate governance standards, in particular regarding minority shareholder protection; corporate transparency standards; and corporate capital rules.

Easy Access to Incorporation

We suggest first that the Alderney company registry should be modernised, and in this respect the UK experience may be useful for considering how Alderney may provide an attractive and accessible service for incorporating businesses, whether domestic or international. For example, Alderney may wish to embark on providing online incorporation as is available in the UK. Standardised and user-friendly incorporation forms can be provided online[60] and persons wishing to incorporate a company in Alderney can access those directly. This may not mean that incorporation agents are completely phased out, but it provides more empowerment for the individuals who wish to start companies.

We also suggest that in order to support an incorporation jurisdiction, the suite of registry services provided may be of crucial importance. The experience of the UK company registry may be useful for Alderney. The UK company registry houses a number of registers of information, and also provides services for companies on an on-going basis. For example, the register of security can provide useful information on the creditors of companies who

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[58] Dale Murphy, *The Structure of Regulatory Competition* (Oxford: OUP 2004).

[59] The UK's corporate governance code pioneered in 1992 has seen international adoption, discussed in Klaus J Hopt, 'Comparative Corporate Governance: The State of the Art and International Regulation' (2011) 59 American Journal of Comparative Law 1. The UK was also regarded highly in its shareholder protection regime in R La Porta, F Lopez-de-Silanes, A Shleifer and R Vishny, 'Law and Finance' (1998) 106 Journal of Political Economy 1113, Christopher Bruner, *Corporate Governance in the Common Law World* (Cambridge: Cambridge University Press 2014).

[60] https://www.gov.uk/topic/company-registration-filing/starting-company.

hold security in company property.[61] The register can encourage or indeed compel creditors of companies to register their security rights over company property, so that the encumbrances over company property are transparent for all to see, and creditors can be treated fairly and be more certain of their rights.

A register of company meeting resolutions would allow members of the company to be aware of what decisions have been made at the general meetings of companies. The register of overseas branches[62] provides useful information regarding a company's wider footprint, while the register of auditors[63] provides information on eligible auditors that companies can look to in order to meet their corporate transparency obligations. The registry could be branded as a first port of call for meeting international transparency requirements, striking a balance between both holding information for compliance purposes and the use of information by constituents, that is, the corporate and investor sectors.

The UK registry also provides useful on-going services such as removing dormant or defunct companies so as not to clog up the register but allowing for easy restoration if one applies to restore the company that has been removed.[64] Further, the UK registry provides a simple tribunal for adjudicating between persons who have a dispute about similar company names.[65] These may not all be suitable for Alderney as enhanced capability on the part of the registry requires more public investment. However, it would be useful to keep in view the salience of the capabilities of company registries for the purposes of international regulatory competition.

The Legal Framework for High Standards of Corporate Governance

The legal framework for corporate governance, in particular, protection for minority shareholders, is increasingly viewed as being important with the rise of institutional investors, whether in listed or private companies (private equity funds for example). Many institutional investors such as pension funds tend to be (as required by their fiduciary duties or national legislation) diversified investors with an investment footprint across a wide range of corporate equity in the developed and increasingly, the emerging, jurisdictions. This however means that institutional investors are unable to hold significant stakes in investee companies and would likely be in the position of minority shareholders. Minority shareholder protection is important not only to ensure that minority shareholders do not suffer from expropriation, but also to allow such sophisticated shareholders to hold

[61] S885, UK Companies Act 2006.

[62] S129, UK Companies Act 2006.

[63] S1239, UK Companies Act 2006.

[64] S1038, UK Companies Act 2006.

[65] S66-74, UK Companies Act 2006.

management in companies to account. Further, such sophisticated shareholders are incentivised to scrutinise corporate performance closely, as they owe duties of accountability for their investment performance to ultimate savers and beneficiaries. Minority institutional investors increasingly see their corporate governance role and rights as being of crucial importance to their investment interests. In recent years, many institutions have also delegated fund management to asset managers, and the increasing popularity of a few large asset managers[66] has also contributed to the consolidation of their influence in ensuring that adequate minority shareholder protection standards and good corporate governance standards are in place.

In our Gap Analysis, we identified a few key areas that would enhance the minority shareholder protection regime in Alderney. First, reforms can be made to the legal framework surrounding general meetings and voting in order to ensure that minority participation can be easily facilitated. Secondly, reforms can be made to clarify directors' duties and liability consequences, as well as in relation to derivative actions by minority shareholders. Thirdly, Alderney can consider bringing in a Corporate Governance Code for key sectors on its corporate register that may benefit from greater investor appeal, such as Guernsey has done for companies in its financial sector.

(a) Minority Participation in General Meetings

In the Gap Analysis, we identified broad similarities between the UK and Alderney Acts in terms of the general meeting as the forum for collective decision-making by shareholders. These included shareholders' rights to be notified of, attend and vote at the general meeting together with procedural safeguards for the due conduct of general meetings. However, there are a few enhancements that the UK Act can offer. We suggest that minority shareholders should have easier access to the requisitioning of meetings, and the threshold of shareholding for such requisitioning should fall from the 10% in the Alderney Act to 5% as provided in the UK Act. A threshold of 10% would be rather high for highly diversified institutional shareholders.

We are of the view that the special provisions in the UK Act that protect members that participate in public and traded companies' general meetings are important and particularly appealing to minority shareholders. This is in line with the general enthusiasm that UK policy makers have for institutional shareholders to engage with their investee companies. It is perceived that greater institutional shareholder engagement with their investee companies may encourage a more accountable and responsible business culture in the publicly traded

[66] For example, BlackRock which is the largest global asset manager with $4.65 trillion of assets under management, see http://uk.businessinsider.com/r-blackrocks-quarterly-profit-falls-33-percent-2015-1?r=US&IR=T; also Vanguard, with $3.4 trillion in global assets under management, see 'Investment: Vanguard's Commanding Position', *Financial Times* (27 May 2015).

sector.[67] If Alderney is interested in attracting incorporations from the public and traded companies sectors, the UK Act provides a leading example for protection of minority shareholders' voice and rights, which could be very attractive for institutional investors. We highlight the longer time periods[68] provided in the UK Act[69] for the circulation of meeting documents to members and specific provisions that allow shareholder voice to be expressed, such as the obligation imposed on a company to answer a member's question at meetings where such questions are not defamatory, frivolous or vexatious. [70] Further, the UK Act provides for an independent assessor process[71] if members of a public company wish to scrutinise how any poll called at a general meeting is conducted. This is a useful process in the case of public companies with large diversified shareholdings, as any issue as to how votes have been counted at poll, and whether a resolution is validly passed, may be determined in accordance with this process. The availability of this process prevents excessive dispute resolution and litigation.[72]

(b) Electronic Communications and Meetings

The Alderney Act currently does not contain any provision on modernised forms of communication for the purposes of arranging and conducting general meetings. Electronic forms of communication would be highly welcomed by institutions who may find it cumbersome to have to deal with physical post or attendance. A legal framework that provides for such modernisation subject to safeguards would be attractive and lessons can be learnt from the UK.

The UK Act provides for notice of a general meeting to be circulated by a prescribed means in relation to posting on the company's website.[73] The Act allows meeting documents to be sent in electronic form to members.[74] Traded companies must provide an electronic address for all communications to be sent and received.[75] Meetings can also be conducted via

[67] The vision of the Kay Review (2012), above.

[68] Section 95, Alderney Act providing for 10 days of notice.

[69] Section 307(2), UK Act, providing for 21 days of notice.

[70] Section 338A, UK Act.

[71] Sections 342-351, UK Act.

[72] Members with at least 5% voting rights or at least 100 members may ask for an independent poll report, and directors would have to appoint an independent assessor to conduct such report. The criteria for 'independence' are provided in the UK Act.

[73] Section 308, UK Act.

[74] Above, also section 309, UK Act.

[75] Section 333A, UK Act.

electronic means, although there are some safeguards for the publicly traded company.[76] Where a publicly traded company holds electronic meetings, those participating in such meetings must be identified and the nature of the meeting must be proportionate to the objectives intended to be achieved.[77] These provisions that modernise the ways in which a general meeting can be validly communicated, organised and conducted are useful for adaptation in the general modernisation of Alderney company law.

(c) Improving Directors' Accountability

We are of the view that a key tenet of minority shareholder protection lies in how directors' duties, responsibilities and accountability are framed and enforced. In this respect, the UK offers some enhancements although not all of the UK Act's provisions on directors' duties are optimal. In terms of enforcement, although the UK Act's statutory derivative action may seem procedurally cumbersome, jurisprudence has developed to clarify and make the process work, and some useful lessons can be offered for Alderney too. The existence of a clearly defined derivative claim, albeit rarely used, nevertheless provides an important accountability mechanism to the managerial power vested in the board.

The Alderney Act sets out clearly that directors are required to act in accordance with the constitution, act honestly and in good faith in the best interests of the company,[78] act with due diligence, care and skill,[79] and be bound to declare interests if directly or indirectly interested in a transaction that the company proposes to enter into.[80] The UK Act in comparison sets out comprehensively what directors' duties are owed to the company. Although the UK can count on its body of common law, which will doubtless be persuasive for Alderney, the UK decided in its company law reform in 2006 that a codification of directors' duties is more business-friendly (particularly within an increasingly global economy) and more sharply focuses the development of case law jurisprudence in a coherent manner.

We suggest it may be useful to study the specific UK provisions on directors' duties not provided for in the Alderney Act, such as the duty to exercise power for proper purposes,[81]

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[76] Section 360A, UK Act.

[77] Companies Act 2006 read with Companies Act (Shareholders' Rights) Regulations 2009.

[78] Section 82, Alderney Act.

[79] Above.

[80] Section 83, Alderney Act.

[81] Section 171, UK Act.

the duty to exercise independent judgment,[82] to avoid conflicts of interest[83] and not to accept benefits from third parties (i.e. bribes).[84] The duty to exercise power for proper purposes allows the company to challenge directors in their decisions where those decisions are of mixed motivations. Not every such decision will be struck down but at least an opportunity for examination is afforded.[85] The duty to avoid conflicts of interest is a strict prophylactic duty to ensure that directors are not in any way affected by tainted concerns while making decisions. The slightest likelihood of conflict of interest should be avoided, and UK case law has interpreted this very strictly.[86] This is in the nature of a strict fiduciary duty, and may be regarded as a standard of good governance. If we take the provision in the Alderney Act relating to declaration of interests as the only means of controlling for directors' conflicts of interest, the Alderney provision is relatively weak compared to the UK's fiduciary standard. This directors' duty is of particular importance to investors as a form of controlling the 'agency' problems[87] on the part of directors. It may also be useful to spell out a duty not to accept benefits from third parties although such a duty would be related to the duty to act in the best interests of the company, to exercise independent judgment and to avoid conflicts of interest.

Finally, the UK Act now requires directors to act in good faith to 'promote the success of the company for the benefit of its members as a whole'. This formulation is not without interpretive ambiguities,[88] and is being developed in UK courts.[89] We do not in particular recommend that this formulation be adopted for Alderney. In our view, the director's duty to act honestly and in good faith for the best interests of the company is clear enough as

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[82] Section 173, UK Act.

[83] Section 175, UK Act.

[84] Section 176, UK Act.

[85] *Eclairs Group Ltd v JKX Oil & Gas Plc* [2013] EWHC 2631 (Ch); *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598.

[86] *Bhullar v Bhullar* [2003] EWCA Civ 424; *Item Software (UK) Ltd v Fassihi* [2004] EWCA Civ.

[87] Michael C Jensen and William H Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3 Journal of Financial Economics 305.

[88] Andrew Keay, 'Good Faith and Directors Duty to Promote the Success of the Company' (2011) 32 The Company Lawyer 138-143; 'Section 172(1) of the Companies Act 2006: An Interpretation and Assessment' (2007) Company Lawyer 106.

[89] For example see *Stainer v Lee* [2010] EWHC 1539 (Ch); most of the recent cases dealt with the easy issue of breach of fiduciary duties where wrongdoing on the part of directors has occurred, see for example *IT Human Resources Plc v Land* [2014] EWHC 3812 (Ch); *Richmond Pharmacology Ltd v Chester Overseas Ltd* [2014] EWHC 2692 (Ch).

supported by much established case law.[90] The UK provision intends to clarify that directors need to take into account stakeholder concerns in decision-making, but primary accountability still lies to shareholders. The usefulness of this provision may be overtaken by corporate reporting provisions (in the UK and EU) which increasingly refer to corporate responsibility and stakeholder matters.[91]

The UK Act provides that breach of directors' duties attracts civil consequences[92] such as disgorgement of profit, compensation of damages and, where directors have failed to declare their interests after a company has entered into a transaction s/he is interested in, criminal consequences can entail.[93] This regime is more stringent than under the Alderney Act, which spells out civil consequences only for failure to declare interests,[94] presumably leaving the consequences of other breaches to common law (although similar remedies may apply). Remedies for breaches of directors' duties are important to investors' perceptions of the soundness of the legal framework for corporate governance. Hence, the comprehensive approach taken in the UK towards directors' liability should be further studied by Alderney.

Under both Acts, the general meeting may ratify directors' breaches.[95] However, the UK Act requires that ratification can only be carried if a majority of disinterested members vote in that way. This prevents interested large shareholders from perpetuating questionable conduct in the company. We recommended that the UK provision on ratification represents a standard of good corporate governance and ensures that disinterested minority shareholders have their say meaningfully on such important matters of corporate governance.

Of course strengthening the regime for directors' liability should be accompanied by ease of access to shareholder enforcement such as the minority derivative action. The UK Act has also codified this action[96] and has clarified how such actions are to be brought and the role of courts in permitting such an action to be continued. We recommend that the UK provisions are worthy of study. Although Armour et al find in empirical research[97] that the

[90] *Re Smith and Fawcett Ltd* [1942] Ch 304.

[91] See discussion below on corporate transparency standards.

[92] Section 178, UK Act.

[93] Section 183, UK Act.

[94] Section 83(4) ff, Alderney Act.

[95] Section 239, UK Act, section 82, Alderney Act.

[96] Sections 260-263, UK Act.

[97] John Armour, Bernard Black, Brian Cheffins and Richard Nolan, 'Private Enforcement of Corporate Law: An Empirical Comparison of the UK and US' (2009) 6 Journal of Empirical Legal Studies 687.

minority derivative action is seldom mounted and almost never in relation to public companies in the UK, the existence of such a framework is still important and underscores the extent of minority shareholder rights and protection.

The UK's codification of the derivative claim sought to bring clarity to the 'obscurity and complexity'[98] of the previous common law regime. Under the UK Act, a derivative claim may be issued by a shareholder on behalf of the company in respect of an act or omission of a director involving negligence, default, breach of duty or breach of trust.[99] In doing so, the UK Act arguably extended the remit of the common law action, by enabling a claim to be issued in cases of 'pure' negligence.[100] Not surprisingly, this expanded scope gave rise to concerns that the reforms introduced by the UK Act could open the floodgates to shareholder litigation.

In response to these concerns, and to mitigate vexatious claims, the UK Act sets out a prescriptive two-stage procedure that a shareholder must satisfy to continue a derivative claim.[101] First, the shareholder must demonstrate to the court that it has a *prima facie* case (an application heard without submissions by the company) and only then will the court consider whether to grant permission for the claim to continue. This two stage-procedure has been criticised for effectively requiring a 'mini-trial' and, in practice (although not without its criticisms),[102] the parties commonly agree to conflate these two procedural steps into one.[103]

One ongoing difficulty with the accessibility of the UK regime (even after codification) is that the costs incurred by a shareholder in issuing a derivative claim are significant, with no guarantee that these will be recovered.[104] As a consequence, it remains a seldom-used mechanism and fears that codification would open the floodgates to litigation have not

[98] The Law Commission, *Shareholder Remedies*, Consultation (Law Com No 142) (1996), para 1.4.

[99] Section 260(3), UK Act.

[100] The common law had previously held that 'mere' negligence was not enough to support a derivative claim (*Pavlides v Jensen* [1956] Ch 565), but that an instance of negligence where the directors had benefited from their conduct would (*Daniels v Daniels* [1978] Ch 406).

[101] Section 261, UK Act.

[102] Namely, that this undermines the efficiency objectives of the two-stage process, which was designed to quickly dispose of unmeritorious claims. See: *Langley Ward Ltd v Gareth Wynn Trevor, Seven Holdings Limited* [2011] EWHC 1893, at [62]-[63].

[103] *Franbar Holdings Ltd v Patel and ors* [2008] EWHC 1534.

[104] Rules concerning costs awards for a derivative claim are set out in Civil Procedure Rule 19.9E.

materialised.[105] Thus, whilst the UK Act provides a helpful model for Alderney to study, any codification would offer the opportunity to carefully consider the procedural requirements (and associated costs provisions) to be introduced. In doing so, this is one area that offers the potential for innovative reform to address the difficulties faced by other jurisdictions.[106] In light of this, we recommended that Alderney consider codifying its derivative claim, reflecting international developments in this area whilst utilising the opportunity to bring clarity and accessibility to what can otherwise be an unclear common law regime.

(d) Pre-emption Rights for Minority Shareholders

The UK Act, in line with the EU's Second Company Law Directive, provides existing shareholders pre-emption rights. Thus, a company must generally not allot equity securities to a person unless it has first made an offer to each person who holds ordinary shares in the company. This protects existing shareholders as they have an opportunity to retain their proportionate shareholding. The scheme is qualified, however, by several exceptions, exclusions, and disapplications. Notably, private companies may exclude all or any pre-emption rights in their articles.

The Alderney Act does not regulate pre-emption rights. However, such rights are valued by shareholders, particularly institutional shareholders. They protect their proportionate shareholdings, transfer the value of potential discounts over market price to existing shareholders, and protect them from control transfers effectuated via share issuances. Although there may be concerns that pre-emption requirements may be overly burdensome on companies, they remain a useful recommendation for Alderney to study, and to consider carefully balancing such rights with countervailing exceptions.

(e) Corporate Governance Standards

In many jurisdictions where there are listed markets, institutional investors have increasingly influenced regulators to introduce high standards of corporate governance for listed companies.[107] Much of these standards are not legislated, but framed as best

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[105] See Armour *et al* note 96 above.

[106] Models to consider include that set out in Part 14 of the UK Act concerning political donations or the introduction of contingency fee agreements as suggested in: A Reisberg, 'Derivative Actions and the Funding Problem: The Way Forward' (2006) Journal of Business Law 445.

[107] There is much empirical evidence on the increased valuation of companies on securities markets driven by investor preferences where good corporate governance is instituted. See Fabio Bertoni, Michele Meoli, and Silvio Vismara, 'Board Independence, Ownership Structure and the Valuation of IPOs in Continental Europe' (2014) 22 Corporate Governance 116; Lawrence D Brown and Marcus L Caylor, 'Corporate Governance and Firm Valuation' (2009) 25 Journal of Accounting and Public Policy 409 (arguing that there are only a few cherished corporate governance notions that make a difference eg independent directors); Kee H Chung and Hao Zhang, 'Corporate Governance and Institutional Ownership' (2011) 46 Journal of Financial and Quantitative Analysis 247; Armand Picou and Michael J Rubach, 'Does Good Governance Matter to

practices, or soft law, so as not to be overly prescriptive.[108] However, they are usually subject to a comply or explain regime,[109] and so there is some pressure for demonstrating adherence. These corporate governance standards have become a basis for shareholder engagement with investee companies. Increasingly corporate governance standards are also becoming relevant for private companies, as minority shareholders are keen to ensure the proper governance of their investee companies and to hold controlling shareholders to account.[110]

Alderney does not currently have a corporate governance code, while the UK is the pioneering jurisdiction of the first corporate governance code[111] which has now inspired international adoption of corporate governance codes.[112] As the corporate governance code seems most pertinent to institutional investors in listed companies, it may be irrelevant for Alderney at the moment without a developed listed market of its own. Further, the relevant listed sector is found in the Bailiwick of Guernsey of which Alderney is part, and Guernsey has issued a corporate governance code for companies in its key sector- finance. Although we do not see the need for recommending the institution of Alderney's own corporate governance code, the Code's principles of due control, scrutiny and accountability of management reflect institutional investors' preferences in securing minority shareholder protection and confidence in the corporate sector.[113] Alderney needs to ascertain the preferences of its constituents on the corporate register and the relevant investor sector. The drivers for corporate governance standards in Alderney need to be specifically

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Institutional Investors? Evidence from the Enactment of Corporate Governance Guidelines' (2006) 65 Journal of Business Ethics 55.

[108] Peer Zumbansen, 'Neither 'Public' nor 'Private', 'National' nor 'International': Transnational Corporate Governance from a Legal Pluralist Perspective' (2011) 38 Journal of Law and Society 50; Larry Catá Backer, 'Private Actors and Public Governance Beyond the State: The Multinational Corporation, the Financial Stability Board and the Global Governance Order' (2011) 18 Indiana Journal of Global Legal Studies 751.

[109] Marc Moore, 'Whispering Sweet Nothings: The Limitations of Informal Conformance in UK Corporate Governance' (2009) 9 Journal of Corporate Law Studies 77.

[110] For eg see the ICAEW, *Good Corporate Governance Guide and Principles for Unlisted Companies in the UK* (2011) at http://www.icaew.com/en/archive/library/subject-gateways/corporate-governance/legal-alert/good-governance-guide-published-for-private-and-other-unlisted-limited-companies.

[111] The First Cadbury Code of Corporate Governance 1992 borne out of the Cadbury Review, see Adrian Cadbury, *The Financial Aspects of Corporate Governance* (1992).

[112] Klaus J Hopt, 'Comparative Corporate Governance: The State of the Art and International Regulation' (2011) 59 American Journal of Comparative Law 1.

[113] Carsten Gerner-Beuerle, 'Determinants of Corporate Governance Codes' (2014) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2346673; Iris H-Y Chiu, 'A Confidence Trick: Ex Ante versus Ex Post Frameworks in Minority Investor Protection in the UK' (2014) 11 European Company Law 6.

ascertained and in due course such development may be needed in its company law framework

(f) Corporate Transparency

In response to numerous corporate scandals, there has been an increasing international convergence towards enhanced corporate transparency. In particular, the provision of reliable financial and narrative (non-financial) reports is seen as fundamental to facilitating corporate accountability and market discipline. The UK and Alderney Acts differ significantly regarding the filing of accounts, and reforms in this area would be a marked departure from the current regime in Alderney. Nevertheless, should Alderney wish to develop its public sector such robust transparency requirements are recommended and the UK Act offers a model for study when considering proportionate accounting reforms.

To help achieve the appropriate balance between the potentially conflicting interests of reducing regulatory burdens and increasing transparency, the UK Act adopts a differentiated approach to corporate reporting. Specifically, the UK Act's reporting requirements depend on a company's economic size and legal status (namely, whether a company is private, public or quoted). In contrast, the Alderney Act only distinguishes between public and private companies. By implementing a more nuanced differentiation between companies for reporting purposes, Alderney could introduce more robust reporting requirements for economically significant entities without imposing undue burdens on smaller companies that do not necessarily pose the risks that a reporting regime is seeking to address.

The UK and Alderney Acts provide for widely different regimes regarding the public filing of accounts. The UK Act requires the public filing of accounts for the majority of companies (although the scope of reporting depends on the classification of the firm) whereas the Alderney Act stipulates that this information need only be provided to company shareholders. Whilst the provision of information to shareholders is fundamental, it is only one objective of a comprehensive reporting regime. Public filing of accounts facilitates board accountability by providing information to the wider stakeholder community including regulators, creditors and trading partners who, whilst lacking the decision-making rights of shareholders, nevertheless have a legitimate interest in the company. [114] The public filing of such information is therefore an important consideration for Alderney as part of any wider governance reforms, particularly if it wishes to develop its public company sector.

A differentiated reporting regime would also help to support the introduction of a proportionate narrative reporting regime, which is seen as increasingly necessary to facilitate effective communication with corporate stakeholders. The UK Act requires that public and quoted companies file a strategic report (on a consolidated basis where

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[114] Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Final Report* (DTI, 2001), para 3.29.

relevant),[115] directors' report, separate corporate governance statement and directors' remuneration report that, together with the financial statements, comprise the company's annual report. These reports help to provide context to the financial reports, identify non-financial matters that are nevertheless relevant to the company's business and are an important part of the reporting framework that is applicable to larger quoted companies.[116]

Any reporting reforms should be supported by a comprehensive audit regime to ensure the accuracy and reliability of the information filed. Currently, both Acts provide for public company accounts to be audited. However, the Alderney Act offers an elective regime for private companies such that (subject to unanimous approval) the members of a private company may elect not to have their accounts audited. Whilst the requirement of unanimity is a high threshold to meet, this nevertheless limits the scope of protection to shareholders. As outlined above, the reporting regime provides information to a wide range of stakeholders beyond current shareholders and we would recommend that any reporting reforms include mandatory audit requirements for economically significant companies.

It is clear that reforming requirements for the public filing of accounts and, in some cases, non-financial reports would entail a significant change to the current regime in Alderney. These changes involve balancing potentially conflicting interests. Nevertheless, corporate transparency is an increasingly expected and important aspect of a robust governance regime that enhances economic growth and public investment. It is therefore a reform that would be prudent to consider for jurisdictions that are seeking to attract international investment.

Corporate Capital

Finally we highlight our recommendations that deal with corporate capital to emphasise some of the business-friendly provisions that have been developed in the UK. The aspects discussed below show that the UK has been responsive to business needs and has avoided being overly prescriptive or stringent where companies may need to restructure their capital position such as in share buybacks. Such provisions may add appeal to Alderney's company law framework as being modern and commercially sensible.

(a) Reduction of Capital

In both the UK and Alderney, companies can reduce their share capital by special resolution and apply to the courts for an order confirming the resolution. However, the UK Act also allows private companies limited by shares to reduce their share capital by special resolution supported by a solvency statement, without the need for court involvement. This

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[115] Introduced by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013.

[116] We do not propose to go into great detail of what the narrative reporting regime entails, for more see Iris H-Y Chiu, 'Reviving Shareholder Stewardship: Critically Examining the Impact of Corporate Transparency Reforms in the UK' (2014) 38 Delaware Journal of Corporate Law 983.

latter option is useful in that it shortens the time and cost associated with capital restructurings, although it is not appreciated by certain creditors. Nevertheless, given the advantages, the option to reduce capital based on solvency statements appears worth considering for Alderney.

(b) Share Buy-Backs, Share Redemption, Treasury Shares

It is regarded as commercially attractive for companies to be able to buy shares back from their shareholders where idle cash is not being put to use in current investment or research. Hence, shareholders, especially institutional investors welcome a balanced and not overly stringent regime for regulating share buy-backs. Subject to certain restrictions, both the UK and Alderney Acts permit companies to purchase their own shares, including any redeemable shares, by way of market or off-market purchases. However, the UK Act appears to be more permissible when it comes to repurchases or redemption by private limited companies. These companies are allowed more leeway in using to a certain extent their capital ('permissible capital') for such purposes (the reasoning behind this apparently being that business owners should be able to withdraw assets to fund their retirement rather than by selling control rights to third parties).

In addition, the UK Act has been recently amended to allow for both off-market and market purchase authorisation by way of an ordinary (instead of special) resolution. The UK Act has also simplified the procedure for share buy-backs from employees or in connection with employees' share schemes, and enables directors to pay for small share purchases out of share capital without going through the procedures that would normally be required for share buy-backs.

Conversely, the Alderney Act does not include such provisions. Among others, it still requires a special resolution in order to sanction any share buy-backs. The UK Act may provide a good example as to modernisation and catering to contemporary needs in terms of capital maintenance requirements.

The UK Act also contains a dedicated chapter on treasury shares. It provides that in cases where the provisions of this chapter apply (essentially for 'qualifying shares' purchased out of distributable profits or a fresh issuance of shares), a company that buys back its own shares may hold any of the shares, sell or transfer them, or cancel them. Shares that qualify to be held by the company and to become treasury shares must be listed shares. As a result, private companies are excluded from holding treasury shares (but may still buy and cancel them). Note that the aggregate nominal value of treasury shares must not exceed 10% of the nominal value of the issued share capital of the class in question. In addition, a company must not exercise the rights attached to treasury shares.

The Alderney Act does not contain such provisions and lacks clarity as to the precise consequences of share buy-backs. Among other benefits, however, introducing treasury shares at least for public companies would provide companies with added flexibility in raising funds without having to allot additional shares (as instead they could simply sell treasury shares).

*(c) **Arrangements and Reconstructions; Mergers and Divisions***

We are also of the view that the UK Act provides useful lessons for Alderney in terms of facilitating private-led restructuring or arrangements by companies. These provisions are attractive as they provide a full range of options for companies in restructuring or in difficulties and avoid stark choices that have to be made if the company law framework is too rudimentary.

The UK, in Part 26, contains detailed provisions on 'compromises' or 'arrangements' (commonly referred to as schemes of arrangement) between a company and its creditors (or any class of them) or a company and its members (or any class of them). Building upon Part 26, Part 27 further contains provisions applicable specifically to mergers and divisions of public companies. Here, the Act defines what constitutes a 'merger' and outlines the steps that are necessary to merge two or more companies. Conversely, the Alderney Act does not contain a dedicated section on either schemes or mergers, although such provisions could be useful and enhance legal certainty for those engaging in restructurings and control transactions.

(d) Takeovers

We are also of the view that there is a need for company law frameworks to provide for how the market for corporate control should work, in the interests of efficiency while balancing the interests of the company's constituents. The Alderney Act does not contain provisions on takeovers and some lessons may be drawn from the UK although its extensive framework including the institution of the Takeover Panel and the implementation of the EU Directive may not be applicable to Alderney's corporate constituents. Perhaps takeover oversight can be added onto the list of registry services that Alderney should develop as a start. However, certain Alderney companies may be subject to the UK's Takeover Code and its provisions relating to control transactions. For instance, the Code applies to all offers for public companies that have their registered offices in the United Kingdom, the Channel Islands or the Isle of Man if any of their securities are admitted to trading on a regulated market or a multilateral trading facility in the UK or on any stock exchange in the Channel Islands or the Isle of Man.[117] The Code does not provide for special rules on its application to Alderney companies. Thus, insofar as they engage in transactions within the scope of the

[117] Detailed provisions on the Takeover Code's applicability can be found in the Code's sections A3–A6.

Code and satisfy the various other generally applicable criteria for application set forth above, Alderney companies will be subject to the Code's rules.[118]

Conversely, Part 28 of the UK Act only affects Alderney insofar as an Alderney company is subject to the Takeover Code, and then only to the extent that the UK Act's provisions are reflected in the Code or the Panel's structure and powers. With respect to control transactions outside of the Code's scope, the Code's rules and the provisions contained in the UK Act's Part 28 do not apply and Alderney is free to implement its own rules. This could extend, for instance, to permissible measures in defending against takeovers (which the Code generally does not allow without shareholder approval).[119] Nevertheless, despite this leeway, Alderney may also wish to follow the examples of Guernsey and the Isle of Man and consider implementing the UK Act's rules on control transactions and/or the Takeover Code's provisions.

(e) Squeeze-out and Sell-out Rights

The Alderney Act does not currently provide for either squeeze-out or sell-out rights which can be useful for minority shareholders in times of corporate restructuring. However, such rights have now been adopted by several jurisdictions. Given their advantages to both majority and minority shareholders, Alderney should consider introducing squeeze-out and sell-out rights as well.

The UK Act also contains provisions for 'squeeze-outs' and 'sell-outs',[120] which address the issues faced by residual minority shareholders subsequent to a successful takeover bid. These rights apply where an offer for all the shares in a company, or all the shares of one or more classes of shares, has been made and the terms of the offer are the same for all of these shares. Squeeze-outs aim to enable a successful bidder to gain full control of a company, even if there are non-selling minority shareholders, while the sell-out procedure's goal is to offer minority shareholders an opportunity to leave a company that has experienced a change of control.

[118] In this regard, it is interesting to note that Guernsey has appointed the Panel to carry out certain regulatory functions in relation to takeovers and mergers under Guernsey law. Also, the rules set out in the Code have statutory effect in Guernsey by virtue of the Companies (Guernsey) Law, 2008 and this Law contains provisions that are equivalent to the UK Act's sections on the Panel's power to require documents and information, restrictions on rights of action for breach of statutory duty, enforcement of rule-based requirements by the court, and the Panel's co-operation and information sharing. Furthermore, the rules set out in the Code have effect in the Isle of Man by virtue of Isle of Man company law.

[119] While according to the UK Act Her Majesty may by Order in Council also direct that any of the provisions of Chapter 1 of the UK Act's Part 28 extend to Alderney, we are not aware of such an extension.

[120] See ss. 979–985.

Squeeze-out rights allow for a mandatory share purchase right granted to a party who has been able to acquire at least 90% of the value of the shares of a company that it bid for and, in a case where the shares to which the offer relates are voting shares, if those shares represent at least 90% of the voting rights carried by those shares. If this threshold is met, the bidder may purchase the shares of remaining minority shareholders who have refused to accept the bid. The shares have to be bought on the terms of the final offer that was made to shareholders; however, shareholders may apply to the court in case they believe that the offer is unfair.

In addition and contrariwise, the UK Act also offers a sell-out right. Here, a target company's shareholders that have initially not accepted an offer for the purchase of their shares are given a way out if the following transpires: If after the purchase offer, which they have not accepted, it turns out that there is a new majority shareholder that holds 90% or more in value of all the voting shares in the company and these shares carry not less than 90% of the voting rights in the company. If that is the case, the remaining minority shareholders can require that the bidder buy their shares. Again, shareholders may apply to the court if they wish to claim that the terms of the original offer – which applies to the sell-out – were unfair.

D. Conclusion

As microstate jurisdictions face challenging times ahead in the landscape of international regulatory competition, Alderney is taking up the challenge to redefine its appeal as a competitive incorporation jurisdiction for internationally mobile capital and businesses.

In this Article, we draw from the comparative law approach adopted in our engagement with the States of Alderney, and suggest areas of company law reform relevant for Alderney. Although we have not validated our proposals based on empirical testing, we suggest that such a comparative law approach is important as it encourages a dynamic of convergence in high standards for international businesses between onshore and offshore jurisdictions while allowing offshore jurisdictions to continue to develop differentiating niches. Such terms of international regulatory competition would move away from merely competing on cost of incorporation or tax advantages (which has been criticised by the international community and is now increasingly subject to international crack-down).

In taking the initiative to reform its company law, Alderney is taking a proactive approach to redefining the terms of international regulatory competition. This takes Alderney towards meaningful competition, as the basis for competition would be the substantive aspects of incorporation frameworks and company law that matter and not merely cost and tax incentives. Such a move would also be constructive for international engagement and hopefully mitigate some of the more aggressive extra-territorial stances taken by onshore jurisdictions of late.